Alternative minimum tax: Impact on charitable giving

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We are working on an update to this report, due to proposals in the 2024 federal budget (among them, an increase to the capital gains inclusion rate) that may affect the content below. For more information, please see the CIBC report titled 2024 federal budget: Selected measures, or Budget 2024 from the federal government.

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The Alternative Minimum Tax (AMT) system imposes a minimum level of tax on taxpayers who claim certain tax deductions, exemptions or credits to reduce the tax that they owe to very low levels. Under the AMT system, there is a parallel tax calculation that allows fewer deductions, exemptions, and credits than under the regular income tax calculation. If the amount of tax calculated under the AMT system is more than the amount of tax owing under the regular tax system, the difference owing is payable as AMT for the year.

Draft legislation containing proposed changes to the AMT rules was released on August 4, 2023. The changes include raising the AMT rate to 20.5% from 15%[1], increasing the amount of income below which AMT will not apply (the “AMT exemption”, estimated to be $173,000 in 2024), and broadening the AMT base by limiting certain amounts that reduce taxes. This report will summarize the proposed changes to the AMT regime that could impact charitable giving.

Proposed changes relevant to donors

In some cases, depending on a donor’s personal tax situation, AMT could be triggered if a charitable gift is made in 2024, when it wouldn’t have been triggered had the gift been made in 2023. For example, this might be the case if a donor earns some tax preferred income (for example, dividend income or employee stock option benefits), or capital gains in the year, and also makes a charitable donation.

Here's a brief overview of tax preferred items that may either generate, or increase, AMT in 2024. AMT, however, could only arise in 2024 where income calculated under the AMT rules exceeds the $173,000 AMT exemption.

Charitable donation tax credit

Under the current AMT rules, the donation tax credit can be fully applied against any AMT owing. Starting in 2024, only 50% of the donation tax credit will be allowed when calculating the AMT. This alone should never cause AMT to be generated, even for individuals with high incomes.

High-income donors generally won’t pay AMT no matter the size of a cash donation if they earn primarily (self)employment or rental income.

Capital gains

Under the regular tax system, only 50% of capital gains are taxable. Starting in 2024, 100% of capital gains will be included in adjusted taxable income for AMT purposes.

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1 All provinces and territories also impose AMT, which is generally calculated as a percentage of the federal AMT. For the purposes of this report, we will ignore the provincial AMT.

As of 2024, capital gains may give rise to AMT. See Example 3 from our report Alternative minimum tax: What's changing for 2024 for an example of how this could arise.

If a significant capital gain is coupled with a donation, which could be the case on the sale of a business or the donation of real estate, the amount of AMT payable could increase. See Examples 1 and 2 in our report Sale of a business: Could alternative minimum tax apply? for illustrations of scenarios where this could arise.

Canadian dividends

Canadian corporations pay tax on their income and can then distribute the after-tax income to shareholders. Under the regular tax system, dividends received by individuals from Canadian corporations are effectively taxed at a lower rate through the dividend tax credit system, to compensate for corporate taxes paid by the corporation.[2] Under the current AMT rules, which will continue for 2024, dividends are taxed at ordinary income rates, without the dividend tax credit system.

Dividend income alone generally won't give rise to AMT. But, when coupled with a cash donation, AMT could arise in 2024.

Donations of publicly listed securities

Under the regular tax system, donors who make in-kind donations to a registered charity of publicly listed shares and units or shares of mutual funds or segregated funds not only get a tax receipt equal to the fair market value (FMV) of the securities being donated (and can claim the donation tax credit), but they also do not pay capital gains tax on any appreciation of the donated shares. Currently, this zero inclusion rate for capital gains arising on in-kind donations of publicly traded securities also applies for AMT purposes. Starting in 2024, however, 30% of capital gains on publicly listed securities that are donated in-kind will be included in adjusted taxable income under the new AMT rules.

For significant donations of publicly listed securities, AMT may result in 2024 where it would not arise if made in similar circumstances in 2023. If the donor is also earning other tax preferred income/gains, then the donation could increase the AMT otherwise arising. See Example 5 from our report Alternative minimum tax: What's changing for 2024?, and Example 3 from our report Sale of a business: Could alternative minimum tax apply? for illustrations of scenarios where this could arise.

Note that since the AMT does not apply to corporations or estates, in-kind donations from a private corporation or an estate will not be impacted by the AMT changes.

Donations of employee stock options

Under the regular tax system, only 50% of the benefit received on the exercise of an employee stock option is included in income[3]. Starting in 2024, 100% of employee stock options will be included in adjusted taxable income for AMT purposes. Where a donation is made on the exercise of a qualified employee stock option of publicly listed securities, so long as certain conditions are met, no benefit is included in income for regular tax purposes. As of 2024, 30% of the benefit will be included in income for AMT purposes.

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[2] This is accomplished by having dividend income "grossed-up," meaning it is increased so that it's roughly equal to the corporation's pre-tax income, and a dividend tax credit is allowed, which roughly equals the corporation's tax on that income.

[3] When an employee exercises an employee stock option, a stock option benefit (equal to the difference between the exercise price and the FMV of the securities) is included as employment income. For certain qualifying options, an employee can claim a stock option deduction equal to 50% of the benefit so that only 50% of the benefit is taxed. There are limitations to claiming of this deduction for stock options issued after June 30, 2021. These are discussed on in our report Employee stock options.

As of 2024, employee stock option benefits exercised in a year may give rise to AMT. See Example 6 from our report Alternative minimum tax: What's changing for 2024? for an illustration of a scenario where this could arise. Furthermore, where shares received on the option exercise are donated, AMT could arise in 2024, and if the donor is also earning other tax preferred income or capital gains, then the donation could increase the AMT otherwise arising.

AMT carryover

If you pay AMT, it can be used to offset tax arising under the regular tax system for the following 7 calendar years. As a result, most taxpayers should be able to recover AMT paid within this time period and thus it may be best to view AMT as a prepayment of that future tax, rather than as an additional tax. The exception to this may be a situation where someone realizes a one-time significant capital gain on the sale of a business, so there will be minimal business or employment income after the year of sale. In addition, AMT recovery may be further impacted by a gift to charity because the individual can no longer earn income on the gifted property.

In such a case, careful planning may be necessary to estimate whether income in the next 7 years will generate sufficient regular tax to offset the AMT in the year of sale. Alternatives could be considered to create taxable income in those 7 years, perhaps through RRSP or RRIF withdrawals, or other means.

Conclusion

While the new AMT rules that start in 2024 are expected to affect very few taxpayers, there are clearly some situations in which AMT could apply to a donor and may impact significant donations to charities in 2024. This means that planning to reduce exposure to AMT may be available. Be sure to speak with your tax professional to see how AMT could affect your situation in 2024, and, if appropriate, consider triggering a gain, exercising employee stock options or making your charitable gift in 2023, when the AMT impact is zero (or lower).

Finally, as AMT does not apply on death or to a corporate donor, consideration could also be given to making a donation via your will or by your private corporation.

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